

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 98-0236**  
**Sales/Use Tax**  
**For Tax Periods: 1994 through 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**I. Sales/Use Tax—Hangers and Pant Grippers**

**Authority:** IC 6-2.5-5-9;  
*Sales Tax Information Bulletin #26: Dry Cleaning and Laundry Establishments Rental and NonRental Services* (April 4, 1983)

Taxpayer protests proposed assessments of use tax on purchases of hangers and pant grippers.

**II. Sales/Use Tax—Mop Treatment Concentrate**

**Authority:** IC 6-2.5-5-8;  
45 IAC 2.2-4-27(d)(4)

Taxpayer protests proposed assessments of use tax on its purchase of mop treatment concentrate.

**III. Sales/Use Tax—Sample Population**

**Authority:** IC 6-2.5-2-1, IC 6-8.1-4-2

Taxpayer protests the inclusion of certain items in the sample population used by audit to project compliance ratios.

**IV. Sales/Use Tax—Name Tags, Emblems, Bar Codes, and Equipment**

**Authority:** IC 6-2.5-2-1

Taxpayer protests proposed assessments of use tax on its purchase of nametags, emblems, bar codes, as well as the equipment required to attach these items to its rental uniforms.

**V. Sales/Use Tax—Computer Hardware and Software**

**Authority:** IC 6-2.5-5-3;

45 IAC 2.2-5-8(g)(7)

Taxpayer protests proposed assessments of use tax on its purchase of computer hardware and software.

**VI. Sales/Use Tax—Missing Invoices**

**Authority:** 45 IAC 2.2-3-27

Taxpayer protests proposed assessments of use tax on its purchase of items from a particular vendor based solely on taxpayer's inability to locate relevant invoices.

**STATEMENT OF FACTS**

Taxpayer rents uniforms. Taxpayer also rents dust mops, doormats, and assorted rags. The rental uniforms, in some instances, may require emblems or logos. When requested, taxpayer will either design or scan, manufacture, and then attach (sew) the emblems and logos onto the rented uniform.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of taxpayer's business for the calendar years 1994 through 1996. This audit resulted in proposed assessments of Indiana sales and use tax. Taxpayer now protests these additional assessments.

**I. Sales Tax—Hangers and Pant Grippers**

**DISCUSSION**

Taxpayer places garments on hangers and pant grippers, presumably to maintain their freshly laundered appearance, prior to rental and delivery. Because taxpayer failed to pay sales tax on its purchases of hangers and pant grippers, Audit proposed assessments of use tax pursuant to 45 IAC 2.2-4-27(d)(4), which instructs:

A person engaged in the business of renting or leasing tangible property is considered the consumer of supplies, fuels, and other consumables which are furnished with the property which is rented or leased.

Taxpayer directs the Department's attention to *Sales Tax Information Bulletin #26: Dry Cleaning and Laundry Establishments Rental and NonRental Services* (April 4, 1983). In section II, entitled "Clean Linen, Towel and Uniform Rental Services," the Department explains the scope of the sales and use tax exemptions. *Bulletin #26* states:

Tangible personal property purchased expressly for rental use, such as linens, towels, uniforms and other garments as well as wrapping materials in which such

rented property is furnished to customers is exempt from sales and use tax liability on the purchase thereof.

In the context of providing uniform rentals, the Department finds that taxpayer's hangers and pant grippers do not represent exempt "wrapping materials and containers." Consequently, these items do not qualify for an exemption pursuant to IC 6-2.5-5-9. Rather, taxpayer's hangers and pant grippers are best characterized as nonexempt "supplies...furnished with the property which is rented or leased." 45 IAC 2.2-4-27(d)(4).

### **FINDING**

Taxpayer's protest is denied.

## **II. Sales Tax—Mop Treatment Concentrate**

### **DISCUSSION**

In addition to renting uniforms, taxpayer also rents dust mops. The mops are "treated" with a chemical concentrate prior to rental. According to taxpayer, treatment is required because dust will not adhere to its dust mops otherwise. Taxpayer explains:

The mop treatment concentrate significantly improves the dust mop in that it attracts the dust to the mop and captures the dust on the mop. Without the concentrate, the mop simply moves the dust around and does not hold the dust in the mop nearly as well. Customers would not be as likely to rent the mops if they were not treated with the concentrate.... In our opinion, the mop treatment concentrate is a material part of the mop and significantly changes the characteristic of the mop and should not be subject to sales tax....

Audit proposed assessments of use tax on taxpayer's purchases of mop treatment concentrate pursuant to 45 IAC 2.2-4-27(d)(4), which instructs:

A person engaged in the business of renting or leasing tangible property is considered the consumer of supplies, fuels, and other consumables which are furnished with the property which is rented or leased.

Audit contends the mop treatment concentrate represented a consumable "furnished with the property [dust mop] which is rented." Rather than "consumed", perhaps "applied" would be a more accurate description of taxpayer's use of its mop treatment concentrate. But regardless of characterization, taxpayer does not "rent" its mop treatment concentrate. See IC 6-2.5-5-8. In this instance, taxpayer's mop treatment concentrate represents a taxable supply pursuant to 45 IAC 2.2-4-27(d)(4).

### **FINDING**

Taxpayer's protest is denied.

### **III. Sales Tax—Sample Population**

### **DISCUSSION**

Computing an error percentage from a sample population and then applying this percentage to sales made in other periods is a commonly understood and accepted accounting practice. Audit explains the methodology used for this taxpayer:

A sample period was selected which consists of March 1994, December 1995, and September 1996. Purchase invoices from expense accounts were examined.... The errors were totaled. The totals from sample period accounts were totaled. Errors found were then divided by sample period totals to obtain a percentage of error. The percentage of error was then applied to yearly totals of the sample accounts. The result [represented]...purchases subject to use tax. [ ] Capital Asset purchases...were not included in the projection.

While taxpayer does not object to the methodology used by audit, taxpayer objects to the inclusion of certain items in the sample population. Taxpayer believes “the following items—printer, wall bracket, poly-taper truck, rail support and tube, and computer terminal and keyboard—should have been capitalized” rather than expensed. That is, these items should have been excluded from the sample population. Additionally, taxpayer notes that Audit included a two-year purchase of pens in the sample population.

Concerning taxpayer’s purchases of printer, wall bracket, poly-taper truck, rail support and tube, and computer terminal and keyboard—taxpayer chose not to capitalize and depreciate these items; rather, these items were expensed. Consequently, Audit properly included them in the sample population.

“Extraordinary expenses” generally will be excluded from sample populations to ensure the validity of the calculated error percentages. Taxpayer’s purchase of pens, however, does not qualify as such an expense because taxpayer’s acquisition of office supplies represents necessary, anticipated, and recurring expenses. It is to be expected that such expenses would be incurred on a regular basis. That one such expense was “captured” in the sample population is neither unusual nor unanticipated.

### **FINDING**

Taxpayer's protest is denied.

**IV. Sales Tax—Bar Codes and Sewing Equipment**

**DISCUSSION**

Taxpayer designs, manufactures, and subsequently attaches (sews) logos, emblems, and name tags to rental garments. Taxpayer also purchases and attaches “bar codes” to each rental garment. Taxpayer contends its purchase of bar codes should be exempt from sales and use tax. According to taxpayer:

Bar codes are of the same nature as logos and name tags. They are attached to each garment and change the garment significantly in that it makes each garment unique. The bar code specifically identifies each garment and benefits the customer in this regard. Therefore, in our opinion, the bar codes qualify for the incorporation exemption.

The bar codes are used by taxpayer for inventory control and tracking purposes. While some method of identifying goods received, inventoried, and rented is essential, such use does not qualify for a recognized sales and use tax exemption—despite the fact that taxpayer charges (and collects sales tax on) “prep charges” for these services.

Taxpayer also protests proposed assessments of use tax on “thread and the equipment required to attach the items [name tags, emblems, and bar codes] to the uniforms [rented]. Specifically, taxpayer argues that thread, “the blindstitch machine and the Juki 206 Auto Darner should not be subject to sales [and therefore use] tax.”

The contested materials (thread) and equipment are used to attach either *purchased* or *manufactured* tags, labels, and logos to rented garments. Regardless of whether taxpayer is attaching *purchased* items to rental garments or attaching *manufactured* items, taxpayer is neither continuing a manufacturing process nor incorporating materials into a manufactured or rented product. Rather, taxpayer is performing a service—preparing its garments prior to rental. The materials and equipment, therefore, qualify for no exemptions.

**FINDING**

Taxpayer's protest is denied.

**V. Sales Tax—Computer Hardware and Software**

**DISCUSSION**

When requested by its customers, taxpayer will design, manufacture, and attach logos and emblems to its rental garments. To assist in the design and subsequent manufacture of logos and emblems, taxpayer purchased computer hardware and graphics software. Specifically, the hardware and software allows taxpayer to create a heat transfer pattern. According to taxpayer, “the products of the design are sold to the customer and sales tax is charged on the sale.”

Consequently, “[w]e are of the opinion the purchase of the Ultragraphics Computer Kit, Monitor and Software are exempt from sales and use tax.”

Audit characterized the utility of taxpayer’s hardware and software as that of “computer aided design.” Audit, therefore, proposed assessments of use tax pursuant to 45 IAC 2.2-5-8(g)(7), which states that “[c]omputers which produce designs which are not sold as products are not exempt. Thus, computer-aided design is a non-exempt function.”

In the context of taxpayer’s business activities, the fact that taxpayer charges its clients an “emblem charge” (and collects sale tax on this charge) will not transform nonexempt design equipment into exempt manufacturing equipment. Taxpayer creates designs as a necessary precondition to its manufacture of logos and emblems. While taxpayer may present its billing charges to reflect each step in the “logo/emblem” process—i.e., design, manufacture, and attachment—such billing does not affect the substance of the activities actually performed.

The Department, therefore, finds that taxpayer’s hardware and software were purchased for, and utilized in, pre-production computer aided design activities. Such usage does not qualify for sales and use tax exemptions. (*Also see IC 6-2.5-5-3.*)

### **FINDING**

Taxpayer's protest is denied.

## **VI. Sales Tax—Missing Invoices**

### **DISCUSSION**

Audit included two expense items in the sample period for which no invoices could be located. Since no invoices were available for examination, Audit assessed use tax on these purchases. Audit cites 45 IAC 2.2-3-27, which discusses documentation requirements:

The person who stores, uses or consumes tangible personal property in Indiana may avoid paying the use tax to the Department if such person retains for inspection by the Indiana Department of Revenue a receipt evidencing payment of the tax.

Taxpayer identified the contested expenses as two purchases (for \$188.02) from a particular vendor (American Heat Seal). Although unable to locate the invoices associated with the contested purchases, taxpayer has provided other invoices from the same vendor. Taxpayer contends that “the attached invoices support the fact that exempt items [patches for shirts and pants] are purchased from this vendor.”

A review of the provided invoices shows that taxpayer purchased certain items from this particular vendor. The Department, however, is unable to identify what particular items were purchased—or ascertain the utility of such items. Additionally, the Department is unable to

conclude that these documented purchases were representative of taxpayer's undocumented purchases.

**FINDING**

Taxpayer's protest is denied.